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Supreme Court, U.S.
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No. 99-395

IN THE
Supreme Court of the United States

VANESSA ARMSTRONG,
Petitioner,

v.

ACCREDITING COUNCIL FOR CONTINUING EDUCATION AND TRAINING, INC., ET AL.,
Respondents.

On Petition for a Writ of Certiorari To The Court of Appeals for the District of Columbia Circuit

PETITIONER'S REPLY TO OPPOSITIONS TO PETITION FOR A WRIT OF CERTIORARI

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December 22, 1999

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Petitioner's Reply

As Respondents recognize, the decision below holds that remedies in an area that is traditionally governed by state law are preempted because they are an "obstacle" to federal objectives. Respondents urge this Court to let that ruling stand, even though there is a federal rule that endorses the objectives of the state law being preempted, and the source of the "conflict" that the Circuit Court identified is nothing more than an agency staff decision to temporarily suspend enforcement of this federal rule.

Respondents do not defend the rationale adopted by the Court of Appeals but, instead, advance an alternative ground that is not found in the opinion below. According to this theory, preemption arises from a Department of Education "determination" that state laws should be preempted unless they limit remedies to circumstances defined as "origination" in federal regulations. *See* Federal Opp. at 3, 9, 12; Educational Credit Management Corp. and Cal. Student Loan Finance Corp. and Bank of America Opp. at 9-10 (hereinafter, "Private Opp.").

Respondents' alternative theory, however, suffers from the same flaw as the Circuit Court's actual reasoning. There simply is no regulation, policy statement, or even interpretive rule that articulates any "determination" by the Department of Education (or the Federal Trade Commission) that state laws preserving borrower defenses must be preempted, or that it is the objective of federal law to immunize lenders from liability.[1]

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[1] Consequently, the question presented here is closely related to the issues currently pending before this Court in *Alexis Geier v. American Honda Motor Company,* No. 98-1811, where, among other issues, this (continued...)

As we show below, each of the Respondents' principle arguments against review is based on flawed premises and does not undermine the reasons for review presented in this Petition.

I.

The preemption issue presented here, and in the petition challenging the preemption ruling by the Eleventh Circuit, (*see Bartels v. Alabama Commercial College*, 189 F.3d 483 (11th Cir. 1999), petition for cert. pending, No. 99-540), warrant review by this Court because, as the Petition describes in detail, billions of dollars in loans have been issued under the federal student loan program, and litigation over outstanding loans now accounts for 60% of the civil cases brought by the United States. *See* Petition at 1-2. The Opposition Briefs in this case argue that these preemption rulings will have little impact because the standard form loan note mandated by statute and implemented by the Department in 1994 contains language comparable to the Federal Trade Commission's Rule on Preserving Consumer Claims and Defenses, 16 C.F.R. Part 433. *See* Federal Opp. at 16; Private Opp. at 13. This argument is mistaken for two reasons.

First, even if the preemption rulings are limited to pre-1994 loans, the impact is substantial. Over $700 million in federal student loans for attendance were issued during fiscal years 1983 through 1992 for students attending proprietary schools alone. *See* Dep't of Education, FY 1992 Loan Program Data

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[1](...continued)
Court is weighing the government's claim that state common law tort liability was implicitly preempted because it would frustrate the objectives of a federal standard that allowed manufacturers to use different types of restraint systems, even though the objectives that would allegedly be frustrated are not articulated in the regulation, and there is no indication that the regulation was intended to preempt common law liability.

Book, at 218-29.[2] Congress has entirely eliminated the statute of limitations on the enforcement of such student loans. *See* 20 U.S.C. § 1091a. Consequently, many of the loans at issue in federal suits or administrative enforcement actions are, like the loans at issue here and in *Bartels*, pre-1994 loans that are just now being enforced. *See, e.g., United States v. Hodges*, 999 F.2d 341 (8th Cir. 1993) (allowing enforcement of 1969 loan).

Second, the D.C. Circuit attributed preemption to a Federal Trade Commission staff decision not to enforce 16 C.F.R. Part 433 which was reversed in 1991 when the staff concluded that student loans are subject to this FTC Rule. *See* Pet. App. 4a-5a, 6a. However, both the Eleventh Circuit decision in *Bartels* and the Respondents' interpretation of the D. C. Circuit's opinion identify the source of preemption as Department of Education regulations on the consequences of schools assisting lenders as part of an "origination relationship." *See* Federal Opp. at 3; Private Opp. at 9-10; Pet. App. in *Bartels v. Riley*, No. 99-540 at 8a. Because these "origination" regulations remain in effect, *see* 34 C.F.R. § 682.206(a)(2) (1999), there is no basis to conclude, either from the these regulations or from any interpretation of the regulations by the Department, that their preemptive effect ended in 1994.

II.

None of the Respondents argues that this Court's decisions support the stated basis for the District of Columbia Circuit's opinion, namely that state law was preempted by the FTC staff's decision to not enforce 16 C.F.R. Part 433 with respect to guaranteed student loan program ("GSLP") loans. *See* Pet. App. at 4a ("Ending enforcement of the Holder Rule with

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[2] The default rates for borrowers who attended proprietary schools during this period are between 50-60%, while the rates for borrowers from other types of schools range from 13-31%. *Id.* at 66.

respect to GSLP loans thus had the effect of protecting lenders from claims and defenses students could raise against schools."). Instead, Respondents urge that the preemption of state law arises from a "determination" by the Department of Education that, unless the lender had an "origination" relationship with the school, state laws that allow borrowers to raise defenses based on misconduct by schools are preempted because they frustrate the objectives of federal law. *See* Federal Resp. at 9; Private Opp. at 9-10.[3]

Respondent's alternative interpretation, however, is just as inconsistent with this Court's preemption jurisprudence as reliance on the FTC staff's non-enforcement decision because there is no Department of Education regulation, policy statement or even interpretive rule that articulates any federal policy or objective that would be frustrated by such state laws. The Solicitor General's Brief asserts that the Department had a "policy" or made a "determination" that the program's objectives would be frustrated unless "lenders were subject to defenses based on a school's misconduct *only* when they had an

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[3]The Eleventh Circuit's opinion in *Bartels* also points to the "origination" regulations to justify its conclusion that state agency law is preempted. The Eleventh Circuit, however, does not cite any "determination" to preempt state law but, instead, asserts that state law must be preempted merely because the regulations permit lenders to use schools as their agents. Pet. App. in *Bartels v. Riley*, No. 99-540 at 8a. Moreover, the Secretary concedes that the Eleventh Circuit's opinion is "erroneous" to the extent that it suggests that the origination regulations are sufficient to preempt state law or that state-law defenses are preempted even when there is an origination relationship. *See* Federal Op. at 9. Of course, if the Eleventh Circuit's reasoning on this matter was erroneous, as the Solicitor General concedes, its holding was also erroneous because the plaintiffs in *Bartels* alleged that the school "originated" the loans at issue, *see* Pet. App. at 9a n.6, and the Department describes "origination" as an "agency" relationship. *See* Pet. Reply App. 94a.

origination relationship with the school (and under certain other limited circumstances not relevant here)." Federal Opp. at 3, 6, 9, 12 (emphasis in original). This assertion is not only inaccurate, but is directly contradicted by the Secretary's official statements on the issue. In 1990, the Department proposed, for the first time, a federal regulation on borrower defenses. 55 Fed. Reg. 48,324, 48,327 (1990). Two years later, the Secretary expressly rejected the proposal because:

> [T]he Secretary has decided that it is not desirable at this time to prescribe in regulations a uniform Federal rule regarding borrower defenses that would preempt state law otherwise applicable to [GSL] programs. The Department believes that the determination of whether a defense under state law is available to a borrower requires a case-by-case assessment of whether individual State laws would frustrate accomplishment of the federal objectives of the [GSL] program.

57 Fed. Reg. 60,280, 60,304 (1992).

Thus, contrary to the characterization in the Solicitor General's Brief, the Secretary expressly decided *not* to make a determination that the "origination" regulations define the only circumstances in which state-law based defenses do not frustrate federal objectives. Since this Court's decisions make clear that proposed regulations that have not been adopted have no preemptive effect, *see Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 171-72 (1978), the Department's *rejected* proposal certainly has no preemptive force.

The origination regulations themselves provide no support for the claim that the Department determined that state laws that permit defenses in any circumstances other than origination frustrate any federal objective. On their face, the regulations do not address preemption, but provide only that lenders may not disavow responsibility for a school's misrepresentations when

the lenders allow schools to perform substantial loan making functions. 34 C.F.R. § 682.200, 682.206(a)(2) (1988). The 1976 notice accompanying the first regulatory language on school-originated loans did not mention preemption, did not articulate any federal interest in immunizing lenders from state laws that protect borrowers when loan making responsibilities are delegated and, indeed, made clear that the objective of these provisions is to *discourage* lenders from delegating loan-making responsibilities to schools. 41 Fed. Reg. 4495, 4499-4500 (1976). The Department's 1986 notice adopting the origination regulations that applied to the loan at issue here, 51 Fed. Reg. 40889, 40936 (1986), also does not contain any indication that the Department concluded that the regulations have preemptive effect, or that there was a federal interest in immunizing lenders from defenses based on misconduct by schools acting on the lenders' behalf.

The Solicitor General's Brief also cites letters from Department officials to a Senator and Representative as support for his claim that the Department determined that lenders were subject to state law defenses "*only* when they had an origination relationship." Federal Opp. at 3-4. The letters are reproduced in the appendix to this Reply, and they show that the characterization of these documents in the Solicitor General's Brief is grossly inaccurate. Apart from the fact that agency correspondence with legislators does not establish federal "law" that could displace state statutes, the letters state that defenses based on misconduct by a school may be available in some circumstances, *including* where there is an origination relationship or the school acts as the lenders' agent.[4]

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[4] Indeed, the statements in these letters indicate that the claims presented in *Armstrong* and *Bartels* should not have been dismissed because

(continued...)

Neither letter states or suggests that the Department has used its regulatory authority to declare that the Department's origination regulations define the *only* circumstances in which state law defenses may be raised.[5]

In short, both the decision below and Respondents' alternative interpretation are based on the theory that state law is preempted because it would frustrate federal objectives – even though there is nothing in federal law that establishes an overriding federal interest in immunizing lenders from liability for fraud or other misconduct of schools that act on their behalf *unless* the lender and school are in an "origination relationship." The statute and the Department's regulations simply do not address the availability of defenses based on misconduct by schools, and this Court's rulings clearly establish that the silence of federal law on this issue does not provide a basis for preempting state laws that do address the issue. *See Freightliner Corp. v. Myrick,* 514 U.S. 280, 282 (1994); *Puerto Rico Consumer Affairs Dep't v. Isla Petroleum Corp.* , 485 U.S. 495, 501-503 (1988).

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[4](...continued)
Petitioners in *Bartels* alleged that the school acted as the agent for the lenders, and Petitioner in *Armstrong* alleged that the school originated the loan.

[5] The only other authority cited for the Secretary's claim that the Department had a "policy" or made a "determination," pursuant to the statute, to preempt state law, *see* Federal Opp. at 3, 9, are the 1990 notice of proposed rule making and 1992 rejection of the proposed rule discussed above, *see supra* at 4, and a 1989 regulation on counseling of students, 34 C.F.R. § 682.604(f)(2)(iii) (1989). The text of these documents does not support the Secretary's claims any more than the letters to legislators and, moreover, they could not support the ruling below because each was issued *after* Petitioner's loan was signed in 1988.

III.

The Private Respondents also argue that the preemption ruling below is correct because the student loan program is "'a comprehensive federal scheme'" that "intentionally leaves a portion of the regulated field without controls.'" Private Opp. at 16 (quoting *Isla Petroleum*, 485 U.S. at 503). But even the courts that have found preemption have rejected this claim, largely because the GSLP is an incentive program in which Congress has expressly preempted state law, but only on specified issues. Consequently, the District of Columbia Circuit and other courts that have analyzed the Private Respondents' claim have concluded that state law generally governs issues that are not covered by the express preemption provisions, including the defenses available to borrowers. *See* Pet. App. at 13a-14a (adopting analysis rejecting field preemption in *Jackson v. Culinary Sch.*, 27 F.3d 573, 580-81 (D.C. Cir. 1994), *vacated on other grounds*, 515 U.S. 1139, *on reconsideration*, 59 F.3d 354 (D.C. Cir. 1995)).

The Private Respondents also assert that the decision below is based on the conclusion that federal law not only permitted, but required, the school's involvement in the preparation of the loan. Private Opp. at 18. The decision below, however, clearly and correctly observes that the actions that schools are *required* to take in loan making under federal law are limited to giving students information, certifying student eligibility, and forwarding applications to lenders. Pet. App. at 3a. Federal law *permits* schools to become more extensively involved and perform functions such as preparing the loan instrument and securing the borrowers' signature, but it does not require that they perform such functions. *See* 34 C.F.R. § 682.206(a)(2). Neither the District of Columbia Circuit's decision here, nor the Eleventh Circuit's decision in *Bartels* accepted the claim that the schools' involvement in loan making was compelled by

federal law, but the Circuit Courts still found preemption because the schools' actions were permitted by federal law.

Indeed, although Respondents, the Circuit Court in this case, and the Eleventh Circuit Court in *Bartels* agree that state law is preempted, they cannot agree on the basis for finding such preemption. This unanimity on result but not on rationale strongly suggests that, like the unanimity of the federal courts of appeals on the preemption question in *Geier v. American Honda Motor Company* (*see* footnote 1), the preemption rulings reflect fundamental confusion about whether state law is displaced by what the Department of Education has done and, just as importantly, has *not* done in this area.

IV.

Finally, the Secretary asserts that, even if the preemption ruling below is incorrect, this Court should decline review because the Circuit Court "improvidently reached" the preemption issue without first resolving the question of whether the choice of law clause in the Petitioners' loan defeated the protections of the District of Columbia statute. Fed. Opp. at 16. The Secretary's argument is hypocritical, since he joined the other Appellees in opposing Petitioner's motion to certify this issue, and Respondents urged the Circuit Court to decide the preemption issue rather than certify the choice of law question (which is an issue of first impression in the District of Columbia, *see* Pet. App. at 29a) to the local court of appeals. *See* C.A. Docket, Federal Appellee's Opposition To Motion for Certification at 8 n.4 (Dec. 2, 1997). Moreover, the issue presented here is not one of constitutional interpretation that should be avoided in favor of non-constitutional grounds because the issue is not the meaning of the Supremacy Clause, but the construction of statutes and regulations.

At best, the Secretary's argument suggests that the decision below should be vacated and remanded with directions to the

Circuit Court to decide or certify the choice of law issue. The Circuit Court's preemption holding should not be left undisturbed on the basis of an alternative ground that the Circuit Court did not address (much less address in Respondents' favor) -- particularly where the choice of law issue can only be authoritatively answered through certification to the local court. The Secretary's argument concerning the choice of law clause is also inapplicable to the Eleventh Circuit's ruling in *Bartels* because there is no claim that any choice of law provision forecloses the agency claim in that action, which was dismissed by the Eleventh Circuit wholly on the basis that the student loan program preempts state agency law.

CONCLUSION

For the reasons stated above and in the Petition, this Court should review whether federal law preempts the application of state laws preserving borrower defenses to federally reinsured student loans.

Respectfully submitted,
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December 22, 1999

APPENDIX TO PETITIONER'S REPLY BRIEF

Letter from Acting Assistant Secretary Kenneth D. Whitehead to Hon. Stephen J. Solarz, May 19, 1988 ... 94a

Letter from General Counsel Jeffrey C. Martin to Hon. Edward Kennedy, Oct. 4, 1991 ..... 97a

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION

May 19, 1988

Honorable Stephen J. Solarz
House of Representatives
Washington, DC 20515

Dear Mr. Solarz:

This responds to your letter of February 10, 1988 to Secretary Bennett concerning former students of Adelphi Institute, Inc. who have outstanding Guaranteed Student Loans (GSL) for attendance at that school.

Many students borrowed under the Guaranteed Student Loan Program to finance their enrollment at Adelphi. These loans were made by various banks and were guaranteed by a number of guaranty agencies, including the Higher Education Assistance Foundation. Each of these guaranty agencies has a reinsurance agreement with the Department. The Department paid interest subsidies on each loan to a financially needy Adelphi borrower that was guaranteed by one of these agencies, and the Department reimbursed the agency for some or all of its losses with regard to those loans on which borrowers defaulted and the lenders filled claims on the respective guarantees.

If a loan is not legally enforceable, it is not reinsurable by the Department, and the Department would not encourage or require a lender or guaranty agency to attempt to collect such a loan. As a legal matter, however, a student who borrows under the GSL program from a third party lender remains responsible for repaying the loan even if the school closes, unless a relationship exists between the lender and the school that would make the school's failure to render educational services a defense to repayment of the loan to the lender. This kind of relationship can arise when the lender makes the school its agent for certain functions in the loan making process. The Department has termed such an agency

relationship an "origination relationship." 34 CFR 682.200.

As you are no doubt aware, students who attend the Gary, Indiana branch of Adelphi have filed a class action challenging the enforceability of several hundred loans guaranteed by HEAF. If the court finds that the school acted as an agent of the lenders and determines that the loans, for that reason, are wholly or partially unenforceable against the borrowers, the Department would honor that determination, and would regard these loans, to that extent, as not covered by reinsurance, and would neither attempt to collect them nor expect guranty agencies to collect them.

The Department has reviewed the write-off criteria and procedures submitted by the Higher Education Assistance Foundation, to which you referred. We cannot approve these standards as written, which includes a policy of forgiving the entire amount owed by borrowers who show some connection with a closed school, without regard to the enforceability of the loan, or, perhaps more importantly, whether the closing prevented the borrower from completing the course of education in which he or she was enrolled.

It would not be responsible to the public for the Department to adopt the kind of general policy of forgiveness on these loans described in the HEAF standards. To the extent, however, that any loan does not constitute a valid, legally enforceable obligation of a borrower, Federal policy has always recognized that such a loan should not be enforced against the borrower, and does not qualify for reinsurance payments from the Federal government.

The Department is currently developing write-off policies and plans to address in future regulations the handling of GSLs in school closing situations. However, at this point we do not expect that the write-off policies or the proposed regulations will provide for excusing repayment on a loan in the event that the school attended by the borrower closes, unless the loan was made or "originated" by the school, and the closure would constitute a legal defense to repayment of the loan.

We encourage students who do not receive what they pay for from a school to vigorously pursue their remedies against the school and any other related or responsible party. However, by agreeing that a school can participate in the GSL program, the Department does not endorse the quality of the educational program of the school, or guarantee that the school will continue to perform its educational program. The statutes under which the Department operates leave the assessment of educational programs to the accrediting agencies, the States, and local authorities with power to regulate the school. The Department can take certain enforcement action where misrepresentations are uncovered, but the extremely limited resources available to conduct this activity, and the thousands of schools that participate in the GSL program, make it unreasonable to expect that the Department can effectively police this field. The responsibility for questioning the quality of the courses and accuracy of the advertising of the schools in the GSL program thus rests with the State and privacy agencies specifically empowered to measure these factors and sanction improprieties, and, of course, with the students themselves. Based on these differences in roles, resources, and responsibilities, we do not believe that it is fair to routinely shift the burden of school failures to the shoulders of the Federal taxpayer.

I hope that this has clarified the Department's position regarding the forgiveness of loans under these circumstances. If you have any further questions, or wish any additional information, please contact Mr. William L. Moran, Division of Policy and Program Development, at 732-5217.

Sincerely,

/s/

Kenneth D. Whitehead
Acting Assistant Secretary

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE GENERAL COUNSEL

THE GENERAL COUNSEL

October 4, 1991

Senator Edward M. Kennedy
United States Senate
Washington, D.C. 20510-2101

Dear Senator Kennedy:

Secretary Alexander has asked me to answer your letter concerning the general legal question of whether, and if so when, students can avoid repaying their guaranteed loans owed to lenders on the ground that their school failed to deliver the promised educational services or otherwise defrauded the student. As you will recall, this issue was raise earlier this year by a West Virginia district court ruling in Tipton v. Secretary of Education.

I apologize for the delay in answering your letter. During this period, the Department has been giving this matter very careful review, and we have refined our position.

Briefly stated, it is the Department's conclusion that banks should be afforded protection from potential liability under state law for school misconduct in most situations, but that there are a few narrow circumstances where it is consistent with federal policy for banks to bear the financial consequences of school misconduct.

In our view, where the bank's relationship with the school in question is no more than one of receiving referrals or cooperating in the paperwork processing, the bank should not be held responsible for student misconduct, and contrary state laws that would let students refuse to repay their loans should be deemed preempted. That will cover standard lending practices in the student loan program, and addresses the principal contrary ruling in Tipton that gave rise to lender concerns.

On the other hand, we think that it is consistent with federal policy for a bank to be held accountable for school misconduct where (1) the bank had notice of prior serious student complaints which were not responsibly addressed by the school, (2) the bank and school are corporate affiliates, (3) the bank had delegated substantial pre-loan functions to the school, thus making the school its agent, or (4) the bank paid finders' fees to the school. Banks may avoid these situations, and potential risks, through their own prudent conduct; yet where they fail to do so, fairness to student borrowers and to taxpayers counsels that banks be held accountable for serious school misconduct.

We are setting forth the Department's position in more detail in a legal brief that we are filing today in the United States District Court for the District of Columbia, and I have enclosed a copy for your information. I have also enclosed answers to the three specific questions accompanying your letter.

If you have any further questions on this subject, we would be happy to meet with you or your staff.

Sincerely,

/s/

Jeffrey C. Martin